



COUNTY OF LOS ANGELES
Internal Services Department

1100 North Eastern Avenue
Los Angeles, California 90063



United We Stand

JOAN OUDERKIRK
Director

TELEPHONE: (323) 881-3939
FACSIMILE: (323) 260-5237

October 1, 2002

To: Each Supervisor

From: Joan Ouderkirk
Director

Subject: **ENERGY UPDATE REPORT**

This is the eighth in a series of regular reports requested by your Board to provide updates on the County's ongoing energy management activities. These reports will be provided quarterly and discuss the status of key energy related issues and responses to recent Board Motions and requests.

Southern California Edison (SCE)/California Public Utilities Commission (CPUC) Settlement Agreement

The Ninth Circuit Court (Court) of Appeals issued a decision on September 23, 2002 that casts doubt on the legality of the settlement agreement by SCE and the CPUC. That settlement agreement, reached in the spring of 2001, implemented surcharges on SCE's tariffs for the purpose of offsetting their high costs for the purchases of power. As power prices drop, SCE revenues from those surcharges are used to mitigate past purchased power debt and restore their financial creditworthiness. The settlement agreement also restricted SCE from further raising rates until at least the end of calendar year 2003.

The Court stated that, in its opinion, the settlement may violate State law in the following three areas:

- Violating the rate freeze provisions of AB 1890 (the original deregulation legislation) by allowing SCE to recover dollars after the end of the legislated rate freeze;
- Violating public utilities code sections which prohibit the CPUC from modifying rates without a public hearing; and
- Violating the Bagley-Keene Open Meeting Act by entering into the agreement in secret meetings.

The Court certified these issues to the California Supreme Court for a definitive ruling on the relationship of the settlement to California State law and stayed further proceedings until the Supreme Court acts. If the Supreme Court declines the

certification, the Court of Appeals has made it clear how it will decide these issues. If the Supreme Court accepts the invitation, its decision will be final.

Accordingly, there is uncertainty regarding rates, potential refunds to customers, Edison's creditworthiness (now predicated on the revenues it has been collecting), and the role of the State (which hoped to get out of the electricity purchasing business once SCE creditworthiness was achieved). We will keep you apprised of all developments in this matter.

Federal Energy Regulatory Commission (FERC) Natural Gas Market Manipulation

This FERC investigation involves allegations that El Paso Natural Gas Co. (El Paso) contributed to the increase in the price of natural gas by withholding pipeline capacity from the California market. The County has been aligned with SCE and the CPUC as active participants in this proceeding.

On September 23, 2002, Chief Administrative Law Judge Curtis Wagner of FERC ruled that El Paso had in fact withheld substantial amounts of pipeline capacity from the California market during the critical winter months of 2000/01. During this period, natural gas prices rose to as much as 20 times historical prices. As a result, the Judge concluded that El Paso did exercise market power and recommended the initiation of a penalty proceeding.

The full FERC board has the authority to adopt or change Judge Warner's decision. If the Judge's decision is upheld by the FERC board, it could order refunds to customers, including SCE and the County. The State has estimated that El Paso made as much as \$900 million on California transactions during that period. We will keep you apprised of ongoing events in this investigation.

During fiscal year 2000-01, the actual natural gas costs for accounts managed by ISD were over \$67 million. This exceeded the original budget amount of \$21 million by almost \$46 million. About 85% of that budget was purchased at volatile California/Arizona border gas prices. The following fiscal year (2001/02), ISD budgeted about \$75 million for natural gas. Actual costs were significantly lower (about \$21 million).

Electricity Direct Access

Assembly Bill 117 was signed into law by the Governor on September 25, 2002. This bill allows local governments (cities and counties) to combine loads of residents, businesses, and municipal facilities for the purpose of purchasing electricity from third

party suppliers beginning January 1, 2003. Any group of cities and/or counties could also form a joint powers agency in order to aggregate their loads and administer the contracts. Additionally, customers will have the option to opt out of any aggregation program and continue to purchase electricity from the incumbent utility.

The CPUC must still determine the appropriateness and amount of departing load fees (discussed below in the CPUC Issues section) and how the cities and/or counties would administer issues such as coordination between suppliers and utilities, signing up customers, billing, ownership of customer information, etc. ISD, is participating in the departing load proceeding at the CPUC in order to evaluate any potential benefits of this new direct access opportunity which also include serving County load (or others) from County owned generating facilities.

Electricity Rates – Other Issues

In August of this year, ISD intervened in SCE's newest general rate case application filed at the CPUC in May of 2002. SCE is requesting this increase in rates to make investments in their transmission and distribution systems and cover increased maintenance and operation costs. This is a separate proceeding than the current proceeding that resulted in surcharges for SCE's self-generated and purchased power. This request represents about a 5% increase in SCE's current revenues, or an additional \$324 million. In October of this year, SCE will submit their first proposal on ~~the details of this revenue requirement and allocation of the rate increase.~~

The Los Angeles Department of Water & Power (DWP) is currently studying a rate adjustment. We have no information at this time on whether rates will be adjusted up or down.

Pitchess Qualifying Facility (QF) Status

In late June of 2002, the CPUC issued a decision accepting the terms and conditions of the Pitchess QF deration settlement agreement signed by SCE and the County. SCE has repaid the County all outstanding debt related to past non-payments and settlement of the plant deration issue.

In a separate issue, this month the California State Court of Appeals rendered a decision upholding the CPUC's decision changing the formula used to determine the amount SCE pays QFs for power production. The Court of Appeals agreed with SCE's contention at the CPUC that the California/Arizona border index was subject to market manipulation and was not appropriate for repaying QFs as part of their cost of power production. ISD has been advised by County Counsel that this decision does not have

an immediate financial impact on the County because SCE and the County entered into a QF settlement agreement (in June of 2002) leaving all past QF payments made by SCE to the County unaffected. The QF settlement agreement also requires SCE to continue to repay the County based on the County's actual costs for gas or the California/Arizona border index price, whichever is less, for a period of 5 years. After 5 years, SCE may opt to repay the County, and other QFs, based on other indices or SCE's incremental cost for producing power. The Court has requested that this issue be settled at the CPUC.

The County joined with the California Cogeneration Council (CCC) in seeking rehearing of the Court's ruling. If the Court of Appeals declines to grant rehearing, this matter will undoubtedly be submitted to the California Supreme Court by the CCC and the County may, at that time, seek review of the Court of Appeals' decision.

Natural Gas

ISD purchases natural gas for the County's largest users and for the cogeneration plants at Pitchess, Civic Center, and Olive View Hospital. Beginning July 1, 2002, ISD has entered into a fixed price contractual agreement with Pacific Gas & Electric (PG&E) Gas Trading, an unregulated PG&E corporation (not affiliated with PG&E's electric utility). The current, fixed price contract is for \$3.45 per MMBtu which is significantly lower than the \$20 per MMBtu peak prices seen in 2000/01. As of the writing of this report, current gas market prices at the California/Arizona border were over \$4.00 per MMBtu and have been so for much of this past quarter (July through September of 2002).

The Pitchess cogeneration plant is on a market index contract through October of 2002. At least through June of 2007, this is essentially a cost neutral arrangement as SCE reimburses the plant for actual natural gas procurement expenses under the QF settlement agreement. ISD has prepared a solicitation for a new market index contract for the next 12 months.

The Utilities Budget for Natural Gas was predicated on a price of \$3.00 per MMBtu for non-core gas. In accordance with budget instructions, no allowance was provided for a contingency in the event of a significant price fluctuation. The price currently in effect for non-core fixed gas is \$3.45 per MMBtu. As a result, we estimate that the gas overexpenditure will be \$2.0 million for the Fiscal Year. ISD will continue to monitor expenditures in this area and will seek Board approval for budget adjustment to cover these additional expenditures, if they are not offset by savings in the budgets for other utility commodities.

Retrofits

At the May 28, 2002 Board meeting, your Board authorized the Director of ISD to enter into contracts totaling about \$4.1 million for energy retrofit projects throughout the County. Project work has begun and should be concluded around December of 2003. Major facilities to be retrofitted with new lighting systems include the Music Center, Olive View Hospital, and the Museum of Natural History. New lighting control systems will be installed at the Registrar Recorder headquarters and the courthouses in Compton, San Fernando, Beverly Hills, Long Beach and Norwalk. Contracts have been signed for the implementation of these projects.

~~As authorized by your Board on June 4, 2002, ISD has contracted with SCE to receive \$3.3 million from the CPUC for additional energy efficiency projects in SCE territory. The funding was made available as part of the CPUC's 3rd Party Local Energy Efficiency Funding Program (Program) for calendar years 2002 and 2003. The Program diverts a portion of energy efficiency funding that is typically administered under the utilities rebate programs. The CPUC evaluated applicants and awarded funding directly to energy companies and other 3rd parties that showed they could create immediate and significant savings.~~

At the same Board meeting, your Board also authorized ISD to solicit bids and sign contracts with Energy Service Companies (ESCOs) on ISD's existing Master Service Agreement to implement these projects. ~~ISD has requested bids on various facilities and anticipates awarding contracts in early October of this year. All project work will be completed by the end of calendar year 2003.~~

Microturbine Project

ISD has negotiated a commitment for funding from the SCAQMD for the installation of 3 – 30kW microturbines. The units are being installed by the SCAQMD's contractor and should be operating by mid to late October of this year at Men's Central Jail and Twin Towers. The units were acquired, at no cost, as part of a joint SCAQMD and LADWP project to promote this technology.

The units are anticipated to offset DWP supplied energy to both facilities by over 200,000 kwh annually and will save the County about \$10,000 per year. DWP has modified their rates and significantly reduced the savings produced by microturbines. ISD estimates that funded microturbine projects (these units were free) have simple paybacks of over 10 years in DWP territory and about seven years in SCE territory. The paybacks can be reduced if the microturbines are used in a cogeneration type installation (i.e., where waste heat is utilized for building uses).

Department of Energy (DOE) Energy Star Recognition for Courts

As reported in the last report, the DOE awarded its "Energy Star Building" label to the Long Beach Courthouse (4th District) earlier this year. Since then, ISD has received Energy Star Building labels for Rio Hondo Courthouse (1st District), Alhambra Courthouse (5th District), Santa Monica Courthouse (3rd District), and Compton Courthouse (2nd District).

This significant energy industry award recognizes these courthouses as in the top 25% energy efficient buildings in the country for their class. ISD had retrofitted each with energy efficient lighting, air conditioning systems, and an energy management control system. The DOE's Energy Star Building program compiles building operating data into a nation-wide facilities database, evaluates energy performance and recognizes the top performing facilities. ISD continues to compile and submit applications to the DOE database on behalf of other County facilities that also have undergone comprehensive energy projects.

Energy User News Building Award

In September of this year, the Energy User News (a major utility industry trade journal) awarded the County a 2002 National Building Award for "Best Multi-Site Project." The Project involved retrofits at 83 County sites totaling about \$14 million, managed by ISD ~~and implemented under a SCE Standard Performance Contract program that provided incentives based on a guarantee of project savings.~~ The County will be recognized and will receive this award as part of the 2002 World Energy Engineering Congress Conference.

I-6 Insurance Lawsuit

With your Board's approval, the County has filed a lawsuit against Caliber One Indemnity Company (Caliber One) for breach of contract and insurance bad faith. Under an insurance policy, Caliber One agreed to provide insurance covering penalties assessed to County accounts as part of SCE's Interruptible Tariff (I6) program. Under the I6 program, SCE assessed penalties to the County during the fall of 2000 through spring of 2001 as the State experienced numerous supply shortages and requested energy curtailment periods. A claim for \$5 million was submitted to Caliber One and they submitted payment for half the claim and refused payment of the remaining \$2.5 million. Subsequent discussions with Caliber One led to the filing of the lawsuit by the County.

Caliber One has filed a motion for a change of venue outside of Los Angeles County. The assigned judge has continued that motion to October 18, 2002. County Counsel and Caliber One have agreed to non-binding mediation in an attempt to settle the lawsuit.

CPUC Issues

The County remains a participant, or is monitoring issues, in the following ongoing proceedings at the CPUC:

SCE Rate Increase

SCE's request in October of 2000 for a rate increase to cover ongoing energy procurement losses ultimately led to the surcharges now implemented in their rates. The surcharges were included as part of the settlement agreement between SCE and the CPUC. The State Court of Appeals recent decision, described above, may ultimately impact these current rates. We will monitor all activities and inform you of any new developments.

QF Repayment Proceeding

As described above, the Court of Appeals decision regarding the payment to QFs for power production requires the CPUC to hold additional hearings on these issues. The County is currently an intervener in the CPUC proceeding related to QF payments.

Utility Procurement Procedures

This proceeding may also be affected by the potential outcome of the Court of Appeals decision and a future decision by the State Supreme Court. Since the settlement agreement between SCE and the CPUC, the CPUC established this proceeding to determine how SCE will procure energy for its retail customers. Much of SCE's financial problems of the past were caused by the requirement to purchase energy from the spot market and the restriction against purchasing under long-term contracts.

SCE General Rate Case

In May 2002, SCE filed at the CPUC to collect additional revenues (beginning in 2003) to cover higher operating and maintenance expenses as described earlier in this report (Electricity Rates – Other Issues). These are expenses related to operation of their business exclusive of fuel and purchased power costs. They are requesting an additional \$324 million in revenues. ISD has intervened in this proceeding to determine

the impact to the County of this proposed increase and possibly participate in hearings to determine the allocation of the increase.

Departing Load Fees

The CPUC will begin hearings in a separate proceeding to determine if or how fees should be assessed for customers who install cogeneration or receive power from a third party (direct access). These fees are proposed by the utilities based on contracted power commitments by the State DWR and similar investments made by the utilities to meet future power needs of customers.

With the passage of AB117 and given that ISD is actively studying potential cogeneration applications at various large County facilities, ISD will participate in these proceedings as these departing load fees will impact our economic analyses.

Federal Energy Regulatory Commission (FERC) Issues

FERC's ruling on the Natural Gas Market Manipulation Investigation was discussed earlier. The status of the ongoing FERC Electric Market Investigation and other proceedings are provided below. In addition, we will provide a description of any new issues before FERC that ISD is following and may request your Board's authority to intervene.

FERC Electric Market Investigation

FERC has been investigating market irregularities in the California wholesale markets since January of 2001. In March of 2002, hearings were initiated to determine the amount of refunds due ratepayers. The Governor has stated that California is due \$8.9 billion in refunds. The current phase of this investigation seeks industry expert data related to refund calculations.

This proceeding may be impacted by the FERC ruling on natural gas market abuse as the impacts of natural gas prices on shortages of electricity and the price of electricity in California will be assessed. ISD will continue to monitor this proceeding.

Fact Finding Investigation of Potential Manipulation of Electric and Natural Gas Prices

This FERC investigation was prompted by the recent discovery of Enron correspondence indicating potential market abuse. The findings of this investigation helped support the recent ruling of the FERC judge in the Natural Gas Market Manipulation Investigation.

Complaints on Unjust and Unreasonable Prices in Sales Contracts

This proceeding focuses on the justness and reasonableness of the long-term power contracts the State entered into during the height of the energy crisis. These contracts are currently well above market prices. Complaints and testimony were provided through mid-September of this year. The hearing is scheduled to begin on October 7, 2002.

Natural Gas Lawsuit

The County filed a lawsuit against several natural gas transporters and marketers alleging their participation in a conspiracy to eliminate competition and raise gas and electricity prices in southern California. The complaint named the Southern California Gas Company, San Diego Gas & Electric, Sempra Energy, and various affiliates of the El Paso Corporation as defendants. The County's lawsuit was ordered coordinated in San Diego Superior Court with natural gas lawsuits filed by other plaintiffs, including the cities of Los Angeles and Long Beach. Judge J. Richard Haden is assigned to this coordinated proceeding.

The defendants have brought motions to dismiss the lawsuit in the pleading stages. The hearings for these motions are scheduled for October 2, 2002.

~~Additional Court Proceedings of Interest~~

In the previous energy update report, ISD had reported on a number of other federal and State court proceedings related to California's energy crisis. The State Attorney General has filed a significant number of them. There has been no significant change in the status of these cases. ISD and County Counsel will follow the progress of these cases and report back to your offices with any new developments.

If you have any questions, please contact me or have your staff contact Howard Choy at (323) 881-3939.

JO:HWC:gn

c: Chief Administrative Officer
Each Department Head
County Counsel